WHITE PAPER:

FERC Regulation of Gas Transmission Lines: Implications for Gas Quality Variances

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FERC Relationship to Gas Producers

Although the Federal Energy Regulatory Commission (FERC) does not directly <u>regulate</u> gas producers, its regulatory activities nevertheless do indirectly <u>affect</u> gas producers. Pipeline companies are required by FERC to provide non-discriminatory access to pipeline transportation services, and this paper assesses the implications of FERC oversight with respect to opportunities for gas producers to obtain variances to pipeline gas quality requirements.

CBM Gas Quality Requirements

The U.S. Environmental Protection Agency through its Coalbed Methane Outreach Program (CMOP) promotes the beneficial use of methane from coal mines as one means of reducing atmospheric emissions of greenhouse gases. In pursuing that goal, CMOP is addressing a host of technical and institutional issues, including opportunities and constraints associated with the shipment of coalbed methane (CBM) in natural gas pipelines.

One such constraint is quality requirements levied by gas pipeline companies for CBM that is intended for shipment through their pipelines. CBM as produced from a mine often will not comply with pipeline gas quality requirements without some form of gas processing (e.g., removing or reducing the concentration of contaminants, enrichment, blending). Such gas processing entails an additional production step that increases cost. If CBM producers could obtain variances from pipeline companies to allow shipment of CBM that does not fully comply with normal gas quality requirements, they could improve the economics of their gas production and sales projects considerably.

Implications of FERC Regulation

FERC directly regulates interstate and intrastate gas <u>pipelines</u>, not the producers who ship their gas via the pipelines. The indirect effect of FERC's regulatory activities on gas producers, however, derives from the fact that all shippers (producers) must have access to the same services, specifications, and rates.[1] Thus, offering more relaxed standards (a variance) to a specific shipper may be considered as discriminatory toward other shippers adhering to the normal standards and gas quality specifications set by the pipeline.

If a pipeline company does relax any standard without relaxing it for all customers, that company may be subject to a complaint filed with FERC by a competing customer. A formal complaint would result in an investigation and, possibly, an action against the

[1] Refer to the attached excerpts from FERC regulations.

pipeline company. This situation presents pipeline companies with a clear disincentive to relax any of their standards.

Conclusion

Gas pipeline companies can grant variances to their requirements for pipeline gas quality. FERC regulations assure, however, that if such variances are granted to one of a pipeline company's customers, they must also be granted to all others to avoid potential liability. Therefore, rather than expecting to be offered latitude in meeting pipeline gas quality specifications, CBM producers should pursue means of improving the quality of their product as needed to meet applicable pipeline requirements.

An Illustrative Case Study

Although the FERC regulations are intended to assure that all producers are offered a level playing field, they also present some limitations, as is illustrated by the following anecdote. A pipeline company refused to accept a producer's CBM because the nitrogen level in the gas was 7.9 percent, which exceeded the pipeline company's published specification for inert (non-hydrocarbon) constituents. They refused to grant the producer a variance even though the effect of the CBM's nitrogen content on the huge flows in the pipeline would be negligible. Although the pipeline company's parent was known to have granted variances in certain circumstances, the pipeline company itself operated as an independent entity and chose not to be bound by the actions of its parent.

The CBM producer suspected that the pipeline company was transporting off-specification gas to gas treatment facilities in one of its pipelines, and felt that such transport could constitute precedent for accepting the CBM. Investigation revealed that pipeline companies have different specifications for different categories of pipelines. The so-called "wet gas" lines are good examples. These are "upstream" lines that carry raw natural gas from producing wells to treatment plants where liquid hydrocarbons are removed. High quantities of condensables are tolerated in wet lines. Once the gas leaves the treatment plant or some other designated point, however, strict commercial specifications are normally imposed. Thus, because the gas producer in this example wished to inject CBM into a pipeline for commercial distribution, not into a wet line, the stringent standards did apply, and it was indeed proper for the pipeline company to refuse granting a variance for the CBM.

Attachment: Excerpts from Relevant FERC Regulations

The following excerpts support the foregoing discussion. Although these excerpts contain no direct references to gas specifications, it is understood in the industry that "services" or "operational conditions" include the gas specifications that the pipeline has set for minimum quality.

TITLE 18--CONSERVATION OF POWER AND WATER RESOURCES

CHAPTER I -- FEDERAL ENERGY REGULATORY COMMISSION, DEPARTMENT OF ENERGY

PART 284--CERTAIN SALES AND TRANSPORTATION OF NATURAL GAS UNDER THE NATURAL GAS POLICY ACT OF 1978 AND RELATED AUTHORITIES

Subpart A--General Provisions and Conditions.
Sec. 284.8 Firm transportation service.

(a) Firm transportation availability.
  (1) An interstate pipeline that provides transportation service under Subpart B or G of this part must offer such transportation service on a firm basis and separately from any sales service.
  (2) An intrastate pipeline that provides transportation service under Subpart C may offer such transportation service on a firm basis.
  (3) Service on a firm basis means that the service is not subject to a prior claim by another customer or another class of service and receives the same priority as any other class of firm service.
  (4) An interstate pipeline that provided a firm sales service on May 18, 1992, and that offers transportation service on a firm basis under Subpart B or G of this part, must offer a firm transportation service under which firm shippers may receive delivery up to their firm entitlements on a daily basis without penalty.

(b) Non-discriminatory access.
  (1) An interstate pipeline or intrastate pipeline that offers transportation service on a firm basis under Subpart B, C or G must provide such service without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind.
  (2) An interstate pipeline that offers transportation service on a firm basis under Subpart B or G of this part must provide each service on a basis that is equal in quality for all gas supplies transported under that service, whether purchased from the pipeline or another seller.
  (3) An interstate pipeline that offers transportation service on a firm basis under Subpart B or G of this part must provide all shippers with equal and timely access

to information relevant to the availability of such service, including, but not limited to, the availability of capacity at receipt points, on the mainline, at delivery points, and in storage fields, and whether the capacity is available directly from the pipeline or through capacity release. The information must be provided on an Electronic Bulletin Board with the features prescribed in Sec. 284.10(a) and as required by Sec. 284.10(b).

(4) An interstate pipeline that offers transportation service on a firm basis under Subpart B or G of this part may not include in its tariff any provision that inhibits the development of market centers.

(c) Reasonable operational conditions. Consistent with paragraph (b) of this section, a pipeline may impose reasonable operational conditions on any service provided under this part. Such conditions must be filed by the pipeline as part of its transportation tariff.

(d) Reservation fee. Where the customer purchases firm service, a pipeline may impose a reservation fee or charge on a shipper as a condition for providing such service. Except for pipelines subject to Subpart C of this part, if a reservation fee is charged, it must recover all fixed costs attributable to the firm transportation service, unless the Commission permits the pipeline to recover some of the fixed costs in the volumetric portion of a two-part rate. A reservation fee may not recover any variable costs or fixed costs not attributable to the firm transportation service. Except as provided in this paragraph, the pipeline may not include in a rate for any transportation provided under Subpart B, C or G of this part any minimum bill or minimum take provision, or any other provision that has the effect of guaranteeing revenue.

(e) Limitation. A person providing service under Subpart B, C or G of this part is not required to provide any requested transportation service for which capacity is not available or that would require the construction or acquisition of any new facilities.